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DISCUSSION PAPER No. 70
THE EMERGING ISSUES FOR THE PUBLIC SECTOR

by **DR. DEV GANDHI and DR. ABDUL RAHMAN**

MAY 1995



DISCUSSION PAPER SERIES

DOCUMENTS DE DISCUSSION

The attached paper has been prepared to stimulate thought and discussion regarding our audit activities. The views expressed are those of the author and therefore should not be construed as those of the Office.

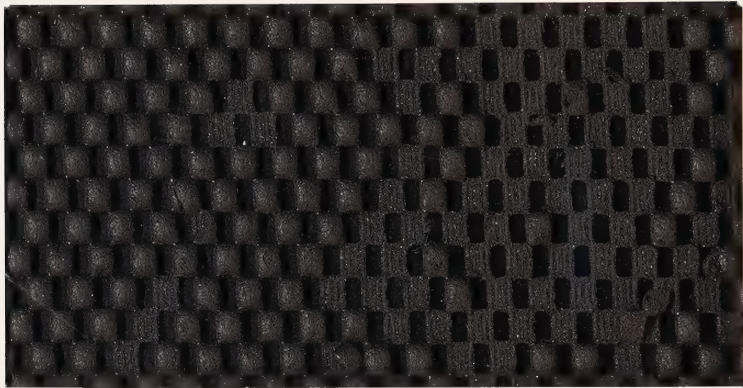
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Le document ci-joint vise à stimuler la réflexion et la discussion sur nos activités de vérification. Les opinions exprimées dans ce texte sont celles de l'auteur et, par conséquent, ne lient pas le Bureau.

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THE EMERGING ISSUES FOR THE PUBLIC SECTOR

BY

Dr. Dev Gandhi and
Dr. Abdul Rahman

December 2, 1994
Executive Seminars International

EXECUTIVE SUMMARY

In this paper, we envision the role of government, in the context of the new economy characterized by the following emerging forces.

The world economy is becoming highly integrated and borderless. The predominant source of a nation's competitive advantage and growth is knowledge and its derivative, innovation. The crucial balancing act is to align these forces to achieve national competitiveness.

However, knowledge—persons are relatively mobile and so present a problem in maintaining the strategic alignment. This necessitates a fundamental role for the government, which is quite different from the traditional one that has been rendered largely ineffective by global forces and limited because of an overwhelming debt load. The new role of the government is to provide **attractors** or attributes of a quality society that will tend to stabilize the knowledge sector.

This new role of government suggest two approaches to selecting auditing issues. The first assesses the extent of skill-building and innovation in product and processes. This examination is **prospective** in nature. The second, which is **retrospective**, involves comprehensive auditing of attractors for the proverbial 3 E's.

EMERGING ISSUES FOR THE PUBLIC SECTOR¹

*Coming events cast their shadows before.
It is as if the future lives in the present, but only in the sublime.²*

Anon

Introduction

To predict the nature and extent of the emerging national and global issues is risky at best. There are many unexpected events lurking at the wayside, waiting to torpedo the expert's finely crafted prognostications.

Not only is it risky business to gaze far into the future, but the economic and social affairs of nations present an additional complexity. Unlike natural sciences, the field of social science does not have the luxury of immutable laws as Einstein's equation or Newton's three laws of nature. It is distinctly more difficult to forecast in social science, but no less important.


We recognize, however, that "coming events cast their shadows before", and in scanning the future public policy environment facing the Office of the Auditor General (hereafter, OAG), we will identify signals and guideposts that point to the key emerging issues.

We develop a model of the role of government in a post-capitalist era that is characterized as "high value not high volume". We argue that the traditional role of government in helping to stabilize the business cycle is constrained by overwhelming debt levels and is rendered largely ineffective by global forces. However, in the new economy, government will be more fundamental. It will have to provide a system of "attractors" that are attributes to enhance the quality of life. These attractors influence the mobility and development of knowledge—persons and aid in the evolution of a knowledge-driven economy to a knowledge-driven **society**.

Some of the issues facing the OAG are derived as a corollary from our model. These emerging issues define important responsibilities for the OAG and suggest modifications to current auditing approaches. In particular, we recommend a two-pronged approach. The first is to assess the extent of skill-building and innovation in product and process. The second dimension involves a comprehensive auditing of "attractors" for efficiency, effectiveness and economy.

¹This paper was prepared for the Office of the Auditor General as input into their strategic planning. The views and opinions put forward are those of the author and no endorsement by the Office of the Auditor General is intended or should be inferred.

²Robert B. Reich, "The Work of Nations", Vintage, 1992

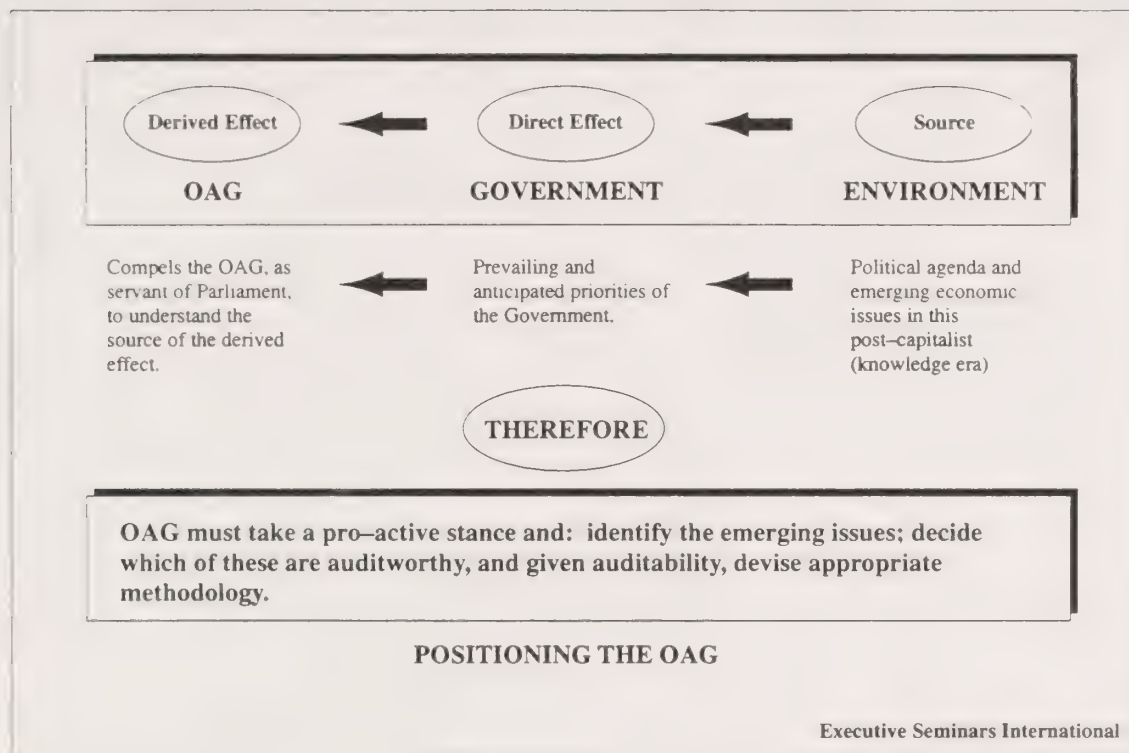


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Positioning the OAG

From a strategic perspective, it is desirable to position the OAG and delineate its environment in a system that includes the federal government with its own emerging issues. We capture this in the following diagram.

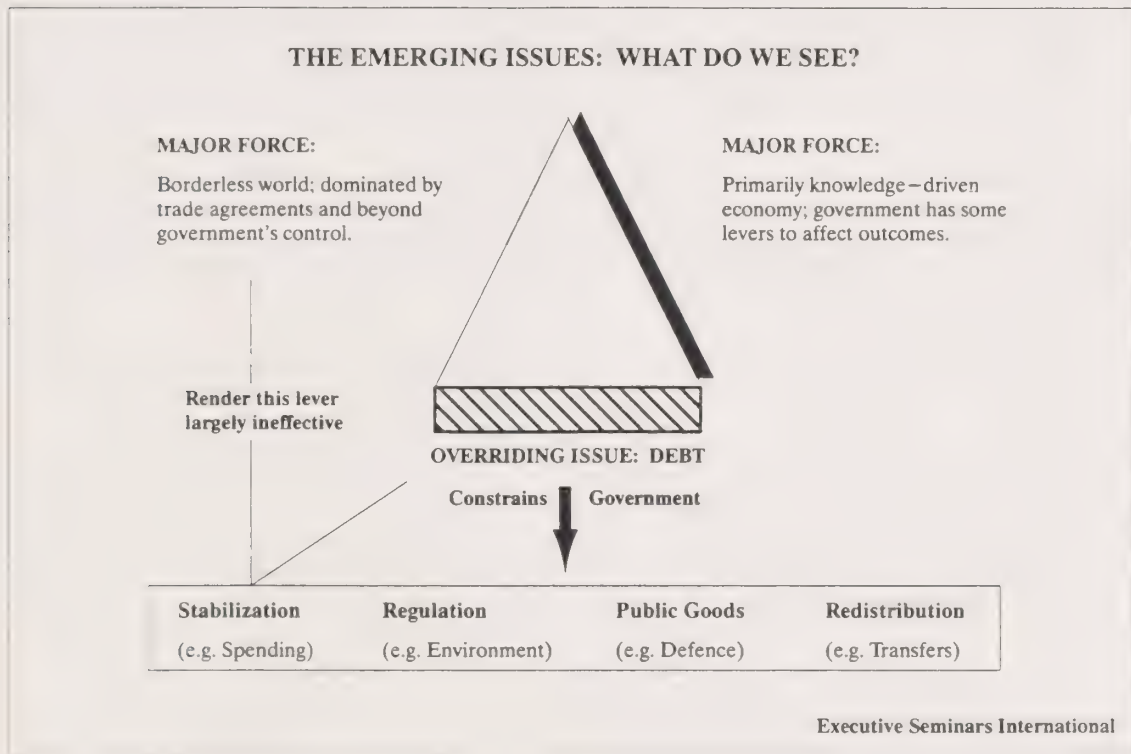


As can be seen, the global and national forces that constitute the environment comprise the **source** of emerging issues that have a **direct** effect on the federal government. For example, the emerging economic issues in the post-capitalist era will have direct effects on the government and these will determine the extent and nature of its anticipated priorities. As a consequence, there will be **derived effects** on the OAG, and, as a servant of Parliament, it will be obliged to understand the source of these effects.

We now discuss a model of the source of these effects, vis-à-vis, the environment. This model is a framework to deal with the question: What are the emerging issues? What do we see from the vantage point of the OAG?

A Model Of The Post-Capitalist Era

The model we propose is illustrated below. The triangle is a metaphorical bird with two wings that capture the two major forces facing all nation states in the new economy. The first major force is the rapid convergence to a borderless world in which economic affairs are dominated by trade agreements, integration of financial markets and the resultant flows of mind-boggling sums of money across borders almost instantaneously as evidenced by the October 1987 world-wide equity market's crash. The Uruguay Round of GATT is expected to increase global competitiveness significantly with a Pareto solution.



The implication for national governments is evident. First, control of macroeconomic policies has weakened. Real and financial markets are becoming inextricably linked. As a consequence, the playing field is fast becoming flat, and governments are forced to regard the **system** of international trade in goods and services as largely **exogenous**. This is particularly the case for Canada. Canada is a major exporting country with the greatest share (80%) going to the United States. This relationship is governed by the NAFTA. Hence, we repeatedly observe evidence showing that the fiscal and monetary policies of Canada react to those in the U.S. This occurred even recently when the Bank of Canada reacted to increases in the discount rate by the Federal Reserve in the U.S. by causing an increase in our benchmark Treasury Bill rate.

So, in our model, the left wing of the triangle is largely exogenous.

In the formulation of the other wing of our model, we take into account the existing research that is embodied in recent publications such as "The Work of Nations" by Reich; "The Post-Capitalist Society" by Drucker and "The Unbounded Mind" by Mitroff and Linstone. The key point in these publications is:

The intensity of world-wide competition (the global web), shorter and shorter product life-cycles and predominance of knowledge as the principal source of comparative advantage demand a “new thinking”. The winner in this economic game will be stationed at the cutting edge of knowledge.

This point is emphasized by Alvin Toffler in “Powershift”

Control of knowledge is the crux of tomorrow’s worldwide struggle for power in every human being. (p.20)

The new economic frontier is clearly the knowledge economy. According to some economists, about 97% of all employment growth will be from knowledge work. In fact the key question raised is: how to move beyond the industrial economy? Trade in knowledge is becoming the main event in international commerce, and trade in knowledge-based goods is rising at a rate of 2 to 5 times faster than in resource-based goods. By 1995, it is projected that trade in information technology, aerospace equipment, electronics and chemicals, by no means the full list of knowledge-based products, will be about 25% of all goods traded in the world.

Clearly, the key to obtaining competitive advantage is to provide incentives for frontier research and innovative approaches to deal with unstructured and unbounded problems that normally arise in fast changing environments; to promote novel approaches to develop intellectual capital that would, by necessity, be embodied in, what is commonly termed “knowledge-persons”. This is what enhances value.

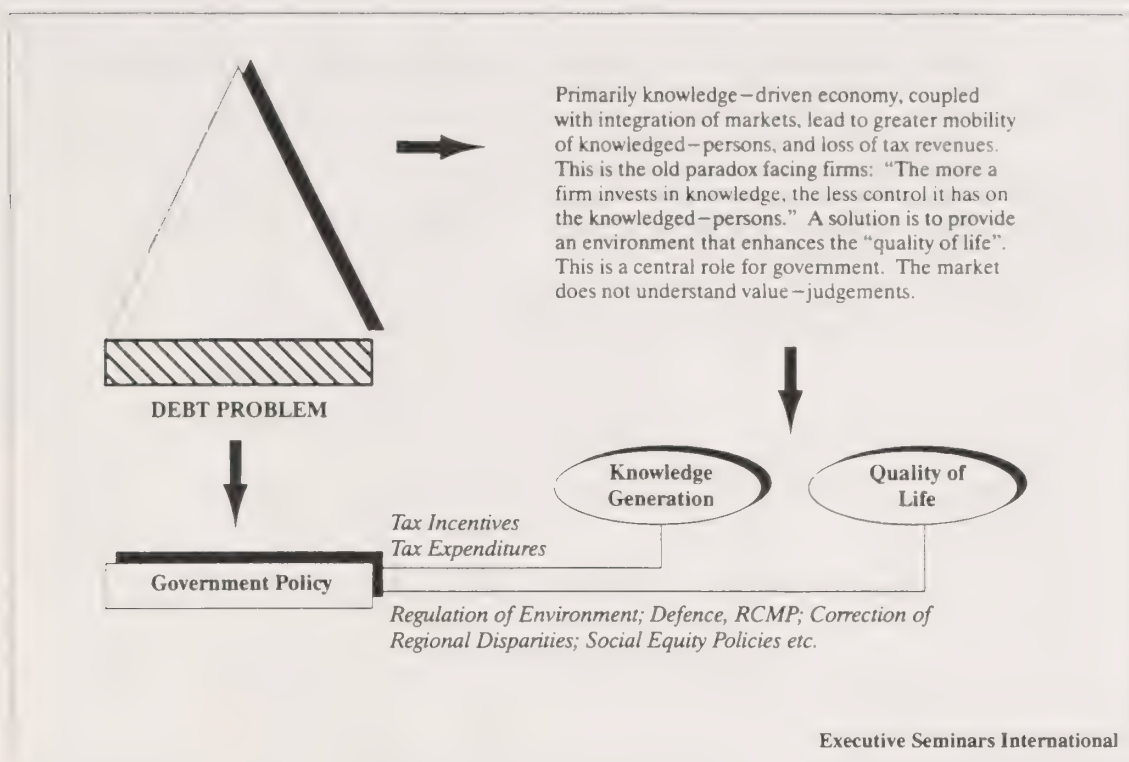
This process of knowledge and skill building must be continuous. The old adage — “if it ain’t broke, don’t fix it” is replaced by: “it is always broke!”.

But there is an inherent paradox in this approach. Given that knowledge-persons are quite mobile, and that existing trade treaties facilitate the free movement of intellectual capital, the more investment in knowledge, the more likely is the mobility of the knowledge-persons! (Incidentally, individual firms face a similar problem. They engage in costly training programs to garner competitive advantage. However, as the market value of such knowledge-employees increases, the likelihood that they might leave is also increased. Consequently, firms, knowing this risk, attempt to keep these employees by designing policies in line with Maslow’s hierarchy of needs).

In this context, we see the role of the government as fundamental in the new economy. Whereas its traditional role of stabilization and activism is de-emphasized, there is a much stronger and central role as part of the solution to the paradox stated above. Much like the individual firm, the government has a role in providing “attractors” that meet Maslow-type needs that would keep the knowledge-person at her/his home-base. By attractors, we mean particular attributes of the quality of life that are not normally provided by the market system. The knowledge-based economy and its attendant brutal competition, makes to provision for societal values. However, it is well known that citizens of a country might be prepared to forego higher after-tax salaries in other economic jurisdictions in return for “safer” communities, easy access to health-care, cleaner environments, etc.

This completes the two wings of the triangle. The first wing represents an exogenous force that each nation must accept as a given. The second wing represents the power of knowledge as a means of competitive advantage. The government has some power and lever to enhance the nation’s wealth through fiscal measures that create intellectual capital and develop attractors that help maintain stability in knowledge-persons.

However, there is a major wrinkle in all of this: the existence of an overwhelming level of public debt in Canada, even if one recognizes the economic benefits of some portion of this debt. We indicate our concern about this problem as a major constraint on government fiscal measures by anchoring the two-winged bird on a platform of debt and deficits. This platform, symbolically, signals the restraining effect of debt on the ability of the economy to take off. There has been much published in the financial pages about the current level of debt and its detrimental effects on the economy. For example, the



nominal value of interest-bearing public debt of the Federal government in Canada to GDP was .36 in 1960, .29 in 1970, .20 in 1980 and .43 in 1990. In fact, current deficits comprise largely interest payments on previously-held debt.

In addition, options for revenue collection through direct income taxation are limited indeed. As reported in the Financial Post (Nov. 18, 1994), "personal income tax already accounts for 44% of government revenue and is 14.5% of gross domestic product, compared to 10.1% in the U.S., our most important competing tax jurisdiction".

Clearly, Canada's debt burden severely constrains expansionary fiscal policy. The traditional role of activism is very restricted. The government must make choices in the presence of binding fiscal constraints. In pursuing a policy of creating appropriate attractors, it must allocate its scarce funds efficiently and effectively.

What are the Emerging Issues Facing The Government?

We summarize these issues and sub-issues below.

WHAT ARE THE EMERGING ISSUES FACING THE GOVERNMENT?

1. Debt and deficits cause the economy to be stuck to the ground. This is the most overriding issue and constrains the effectiveness of those levers still under the control of the government.

We have to let the two-winged bird fly!!

2. The degree of alignment between the "left side" and "right side" of our model is a measure of national competitiveness.

Both wings of the bird must be in unison for effective flight.

3. The levers that the government have in its arsenal are:
tax expenditures to encourage R&D, training, education. But these are limited by the debt problem.

Matching is essential for national competitiveness; debt forces the government to make the "right" policy choices or pay the price.

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1. The first and foremost is debt and deficits. The overwhelming level of debt causes the economy to be stuck to the ground. This is the most overriding issue which constrains the effectiveness of those levers still under some control of the government. The solution of this problem will let the two-winged bird fly!
2. The second issue is national competitiveness. The traditional definitions of national competitiveness are, in our opinion, limited and misdirected. For example, national competitiveness is usually defined in terms of trade performance, real income or quality of goods. For a full list of references, see the "Competitiveness Issue Paper" #2867. However, we believe our model derives an appropriate definition of national competitiveness. The degree of alignment between the two sides of our triangular model is a measure of national competitiveness. Both wings of the bird must be in unison for an effective flight. IN THIS SENSE, NATIONAL COMPETITIVENESS IS A CRITICAL ISSUE FACING THE NATION. NATIONAL PROSPERITY IS CONTINGENT ON THE RIGHT ALIGNMENT OF THE TWO SIDES OF THE TRIANGLE. Canada must pursue policies that render its economic activities CONGRUENT with the given world system of markets and rules of trade. This is the Matching problem facing all nation states.

3. "Quality of life" issues or what we call "attractors" are, in fact, key economic factors. The government must direct its efforts to resolve the matching problem. One way of doing this is to provide attractors that will maintain stability in the knowledge sector and aid in the early development of knowledged–persons. We suggest that the set of attractors be of two categories: those that enhance societal cohesiveness and those that will accelerate the development of a knowledge–society for the post–capitalist era.

3. "QUALITY OF LIFE" ISSUES ARE KEY *ECONOMIC* FACTORS

Knowledged–persons might be less mobile when they consider the overall quality of life in Canada. but the market is unable to make value judgements. Hence, the government has an important role, and a key role, in the new economy! (It is paradoxical that the standard market model finds a very benign, passive and limited role for the government. We argue that the post capitalist (knowledge) era, places a very important role for the government in providing a set of appropriate attractors.

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Category 1

- Environment
- Public Safety and Health
- Non–tax Income Re–distribution and Societal Justice (keep 4/5 well–positioned for the loop)

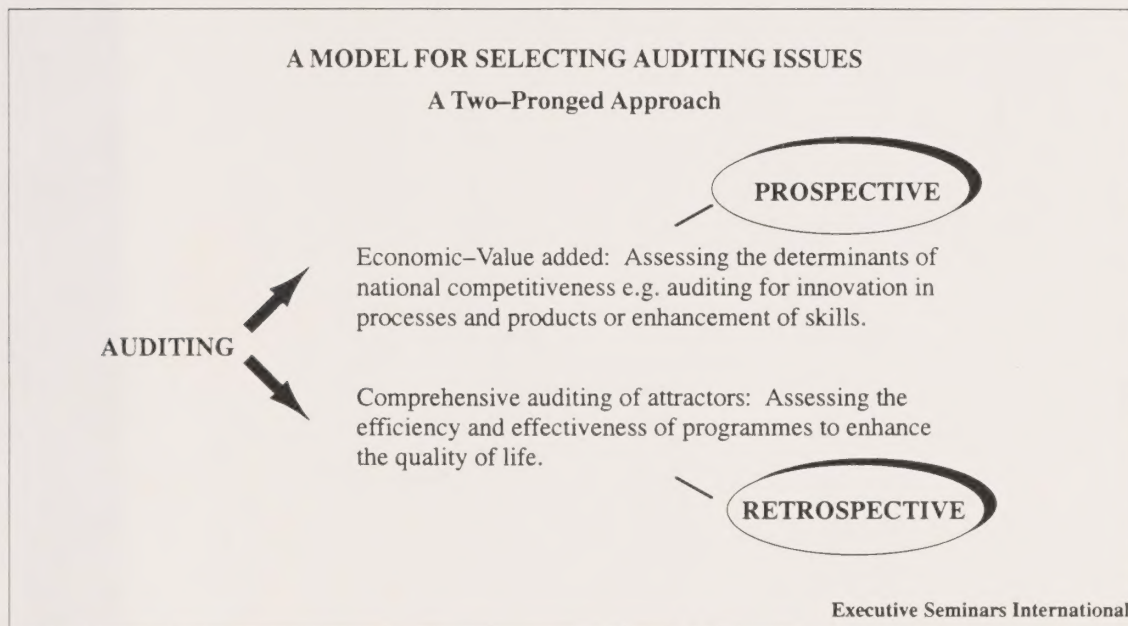
Category 2

- Innovative Early Schooling
- High and Uniform Educational and Training Standards Across the Nation
- Curriculum Relevant to Post Capitalist Societal Needs

What Are The Implications For The OAG?

Up to this point, we contend that the contemporary environment poses a matching problem that must be resolved in order to gain competitive advantage in the global economy, and, in addition, the government loses its traditional role to assume a more fundamental one of providing appropriate attractors so that the knowledge sector is stable and evolving and the matching can be maintained.

We believe that these emerging issues suggest a two-pronged approach to auditing. The following diagram summarizes this approach.



As can be seen, the first prong requires an assessment of the determinants of competitiveness. For example, the OAG could introduce procedures for the auditing of innovation in products, processes, services and the extent of skill-building. This approach to auditing is PROSPECTIVE.

The second prong, deals with the comprehensive auditing of attractors. It assesses the 3 E's of programmes that enhance the "quality of life". This approach to auditing is RETROSPECTIVE.

In summary, it is incumbent on the OAG to be forward-looking in its examinations and conduct of audits. In addition, the emerging projects that should be subject to comprehensive auditing are the key attractors that improve the quality of life in Canada while at the same time serve as key economic factors to minimize the mobility of knowledge-persons, and accelerate the evolution of a knowledge society.



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